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NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

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INFO AMEMBASSY ROM E

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TAGS: ECON, EIND, ELAB, IT

SUBJECT: A BRIGHTER ECONOMIC OUTLOOK

1. SUMMARY. THE ECONOMIC CLIMATE IN THE PO VALLEY HAS SHARPLY IMPROVED SINCE OUR PRE-ELECTION ANALYSES. PICTURE HERE IS OF RECOVERING ECONOMY AND GROWING OPTIMISM DESPITE FUNDAMENTAL PROBLEMS. INDUSTRIAL PRODUCTION IS UP, MAINLY AS A RESULT OF STRONG FOREIGN DEMAND (LED BY US RECOVERY), AND EXPECTATIONS ARE PREVALENT THAT TREND WILL CONTINUE. WHILE MANAGEMENT CONTINUES CRITICAL OF LABOR, IT CLAIMS THAT TRADE UNIONS HAVE BECOME MUCH MORE REASONABLE. BUSINESSMEN CONSIDER LABOR DIFFICULTIES AND HIGH UNEMPLOYMENT RATES TO BE AMONG CHIEF ECONOMIC PROBLEMS. OTHERS SEE CORPORATE INDEBTEDNESS AS MORE SERIOUS. MOST CONSULTED WERE OPTIMISTIC THEY COULD WORK WITH A COMMUNIST GOVERNMENT, ALTHOUGH THEY DID NOT FEEL PROBLEM WOULD PRESENT ITSELF. ALL AGREED, HOWEVER, THAT GOVERNMENT'S INABILITY TO ESTABLISH CLEAR-CUT ECONOMIC POLICY IS SLOWING RECOVERY AND UNDERMINING CONFIDENCE. MAIN

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PROBLEM FOR LOCAL ECONOMY IS NATIONAL POLITICAL CLIMATE WHICH, IF LESS WORRISOME TO LOCAL COMMUNITY THAN

IMMEDIATELY BEFORE ELECTIONS, NEVERTHELESS REMAINS
FUNDAMENTAL UNKNOWN IN THE ECONOMIC FUTURE. (END SUMMARY)

2. IN EFFORT TO ASSESS EXTENT OF ECONOMIC RECOVERY IN
CONSULAR DISTRICT, WE SPOKE WITH BUSINESSMEN, INDUSTRIALISTS,
BANKERS, ECONOMISTS, STOCKBROKERS, NEWSPAPERMEN AND LOCAL
CHAMBER OF COMMERCE ANALYSTS DURING PAST WEEK. WHILE
MANY SERIOUS PROBLEMS PLAGUING ECONOMY LINGER, THERE IS
GROWING OPTIMISM AS RESULT OF THE ECONOMY'S PERFORMANCE
DURING THE FIRST HALF OF 1976 AND SCATTERED EARLY RETURNS
ON POST-VACATION SITUATION.

3. INDUSTRIAL PRODUCTION WAS SUBSTANTIALLY HIGHER DURING
SECOND QUARTER OF 1976 THAN DURING PREVIOUS QUARTER (SEE
MILAN 2053), AND EXPECTATIONS ARE HIGH THAT TREND WILL
CONTINUE. IN ASSOLOMBARDA SURVEY OF MANUFACTURERS, ABOUT
30 PERCENT EXPECTED FURTHER INCREASES IN PRODUCTION DURING
THIRD QUARTER OF 1976. TWENTY PERCENT, PRIMARILY SMALLER
FIRMS, EXPECTED DECLINES. THREE-FOURTHS SAID CURRENT
INVENTORIES WERE ABOUT NORMAL. FIFTY PERCENT (EMPLOYING
65 PERCENT OF SECTOR'S WORKERS), HOWEVER, EXPECTED BOTH
DOMESTIC AND FOREIGN DEMAND TO REMAIN UNCHANGED THROUGH
THIRD QUARTER.

4. IT APPEARS THAT UPTURN IN PRODUCTION IS RESULT OF
GROWING FOREIGN DEMAND FOR ITALIAN PRODUCTS AND MANY ARE
OPTIMISTIC THAT RECOVERY BY ITALY'S TRADE PARTNERS AND
DEVALUATION OF LIRA WILL CONTINUE TO BOOST SALES. VEN
IF LEVEL OF DOMESTIC DEMAND REMAINS BELOW THAT OF RECENT
YEARS, CLAIMED AN OFFICIAL OF THE PADOVA CHAMBER OF COMMERCE,
EXPORT OF SHOES, MECHANICAL PRODUCTS, AND FURNITURE ARE
CONTINUING TO RISE. MANUFACTURERS OF CLOTHING TALK OF
MINI-BOOM CREATED BY STRONG EXPORT DEMAND FOR ITALIAN
CLOTHING, AND MAKERS OF EXPENSIVE CLOTHING IN MILAN SAY
THEY HAVE MORE EXPORT BUSINESS THAN THEY CAN HANDLE. IN
TURNABOUT, BLUE JEANS MANUFACTURER WRANGLER ITALIA
CLAIMS IT IS BEGINNING TO EXPORT TO US. ACCORDING TO
MILAN CHAMBER OF COMMERCE, LARGE INCREASES HAVE COME IN
CHEMICAL, RUBBER, AND FOOD-STUFF EXPORTS. SHIPPING SOURCES
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TELL US THAT BUSINESS IS EXCELLENT WITH AN IMPROVEMENT
OVER THE SITUATION LAST YEAR AND AN EXPECTATION OF
CONTINUED DEMAND FOR SPACE. OUTBOUND SHIPS ARE DEPARTING
FULLY LOADED, A SOURCE OF GOOD CHEER TO SHIPPERS.

5. ALTHOUGH OPTIMISM THAT DOMESTIC DEMAND WILL RISE IS
MORE LIMITED, SOME SECTORS REPORT THAT DOMESTIC SALES ARE
IMPROVING. MONTEDISON VICE PRESIDENT HAS TOLD US OF A
DRAMATIC RECOVERY OF RETAIL SALES IN ITS CHAIN STORES
SINCE END OF AUGUST VACATIONS AND IMPROVEMENT EVEN IN

ARTIFICIAL FIBERS ALTHOUGH THE COMPANY AS A WHOLE IS IN SERIOUS FINANCIAL TROUBLE. COMPUTER PEOPLE, TOO, SAY BUSINESS IS BOOMING, ONE COMPANY CLAIMING THAT SALES IN JULY WERE HIGHEST IN HISTORY. NORMALLY, OF COURSE, THE RISE IN FOREIGN DEMAND SHOULD BE EXPECTED TO SPILL OVER TO THE INTERNAL MARKET AND THAT IS OUR EXPECTATION BARRING FALTERING OF WORLD ECONOMY OR ADDED POLITICAL UNCERTAINTY HERE.

6. FEWER EXPECT RATE OF INFLATION WILL CONTINUE TO DROP. ONE LARGE MILAN BANKER FEELS THAT NEW GOVERNMENT IN ROME HAS DONE LITTLE YET TO CONTROL BASIC PROBLEMS CAUSING INFLATION AND OTHER ECONOMIC ILLS. THEREFORE, HE THINKS IT IS TOO EARLY FOR OPTIMISM. MOREOVER, PEOPLE SEEM TO BE ADJUSTING EXPECTATIONS TO INCLUDE CONTINUED HIGH RATE OF INFLATION. CHAMBER OF COMMERCE OFFICIAL IN ONE PROVINCIAL CAPITAL PREDICTED PRICES WOULD CONTINUE TO RISE AT RATE OF OVER TWENTY PERCENT. ANOTHER MILAN BANKER FELT SEPTEMBER WOULD BE CRUCIAL IN SHOWING WHAT INFLATION TREND WOULD LOOK LIKE DURING REMAINDER OF YEAR. PEOPLE WILL BE BACK FROM VACATION, HE SAID, AND WILL BE BUYING. EXTENT OF THEIR PURCHASES AND EFFECT ON CONSUMER PRICES WILL BE MUCH MORE INDICATIVE THAN WHAT HAS HAPPENED DURING SUMMER MONTHS.

7. GENERAL SENTIMENT PREVAILS THAT LIRA WILL CONTINUE TO DEPRECIATE SLOWLY DURING AUTUMN MONTHS. NEVERTHELESS, PROMINENT STOCK BROKER AND OFFICIAL OF STOCK EXCHANGE WAS POSITIVE THAT LIRA WOULD LEVEL OFF IN NEAR FUTURE. LIRA'S CONNECTION WITH OTHER MORE STABLE EC CURRENCIES WOULD EVENTUALLY STABILIZE IT TOO. SINCE SHARP DROP OF LAST FEW DAYS, HIS CRYSTAL BALL MAY BE A LITTLE OUT OF FOCUS. OTHER BANKERS WE TALKED TO WERE HESITANT TO MAKE LIMITED OFFICIAL USE
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8. TRADE UNION AND POLITICAL OPPOSITION TO MAKING LAYOFFS DURING DOWN TURN IN ECONOMY HAS BEEN MAJOR DRAG ON INDUSTRY. BOTH CAPITAL AND LABOR PRODUCTIVITY DECLINED GREATLY, AGGRAVATING FIRM'S FINANCIAL PROBLEMS. HOWEVER, ANAGERMENT HAS BEEN ABLE TO MAKE SOME DE FACTO REDUCTIONS AND BELIEVES THAT IT IS NOW GETTING QUIET UNION SUPPORT TO CUT ABSENTEEISM AND TO RESTRAIN WAGE AND FRINGE DEMANDS. ALFA ROMEO'S ABSENTEEISM, FOR EXAMPLE, HAS DROPPED BY ALMOST HALF SINCE MAY 1976 CONTRACT SETTLEMENT AND CLIMATE HAS MUCH IMPROVED.

9. MANAGEMENT TACTIC HAS BEEN ATTEMPT TO CUT LABOR FORCE THROUGH ATTRITION AND HIRING SHOPS. DURING SECOND QUARTER OF 1976, WHEN PRODUCTION IN MANUFACTURING IN LOMBARDY WAS SUBSTANTIALLY HIGHER, EMPLOYMENT REMAINED UNCHANGED FROM PREVIOUS QUARTER, MUCH BELOW 1973 EMPLOYMENT LEVELS. IN ASSOLOMBARDA SURVEY MENTIONED PARA. THREE, EXPECTATIONS WERE LOW THAT EMPLOYMENT WOULD RISE. MORE THAN THREE-FOURTHS OF THE FIRMS INTERVIEWED SAID EMPLOYMENT WOULD REMAIN STABLE THROUGH THIRD QUARTER. THIS MEANS, OF COURSE, LIMITED OFFICIAL USE
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RISE IN PRODUCTIVITY WHICH SEEMS GENERALLY TO BE UNDERWAY, THIS CONFIRMS OUR PREVIOUSLY REPORTED VIEW THAT MANAGEMENT HAS USED DOWN-TURN TO BRING IN MORE EFFICIENT EQUIPMENT, EXTEND USE OF COMPUTER, AND OTHERWISE IMPROVE COMPETITIVE POSTURE FOR RECOVERY. PLANT UTILIZATION IS MUCH HIGHER THAN EARLIER. ONE STUDY SHOWS MANUFACTURERS IN LOMBARDY ARE PRESENTLY UTILIZING ABOUT 75 PERCENT OF CAPACITY COMPARED WITH ABOUT THE 66 PERCENT A YEAR EARLIER.

10. MANY ANALYSTS AND TRADE ASSOCIATIONS ARE ALSO CONCERNED WITH LOW LEVEL OF INVESTMENT. STUDY BY AMERICAN CHAMBER OF

COMMERCE IN MILAN SHOWS US FIRMS ACCOUNTING FOR 7 PERCENT OF ALL ITALIAN INVESTMENT IN 1975. OFTEN HEARD EXPLANATION FOR LACK OF INVESTMENT IS THAT AT 20 PLUS PERCENT, INTEREST RATES ARE TOO HIGH. IN THE PADOVA CHAMBER OF COMMERCE STUDY, ONLY 13 PERCENT OF THOSE FIRMS PLANNING INVESTMENT EXPECT TO RESORT TO BANK CREDIT. NOT SO, ARGUED MANAGING DIRECTOR FOR ITALY OF LARGE MULTINATIONAL BANK. HE CLAIMED THAT SINCE REAL INTEREST RATE HAS BEEN NEGATIVE FOR MOST OF PAST YEAR, AND IS NOW ABOUT PLUS ONE OR TWO PERCENT IT DOES NOT MAKE SENSE THAT HIGH NOMINAL RATES ARE CAUSE OF LOW INVESTMENT LEVELS. REAL REASON IS LARGE DEBT SERVICE PAYMENTS FIRMS NOW PAYING BECAUSE OF THEIR HEAVY INDEBTEDNESS. ANOTHER BANKER CLAIMED THAT ITALIAN FIRMS WERE FIVE TO SIX TIMES MORE INDEBTED THAN THEY WOULD PREFER. ALTHOUGH TRUE THAT FIRMS HEAVILY INDEBTED, UNCERAIN POLITICAL AND ECONOMIC CLIMATE NO DOUBT MAJOR FACTOR IN LOW LEVEL OF INVESTMENT. FIRMS WILL INVEST WHEN CERTAINTY OF RETURN IS GREATER.

1. CONCERNING POSSIBILITY OF PCI PARTICIPATION IN NATIONAL GOVERNMENT, MANY BUSINESSMEN, INCLUDING AMERICANS, WHILE HOPEFUL PROBLEM WILL NOT PRESENT ITSELF, ARE OPTIMISTIC THAT THEY COULD WORK WITH COMMUNISTS IF IT SHOULD. ONE BANKER SAID HISTORIC COMPROMISE WAS INEVITABLE AND WAS IN GREAT PART ALREADY REALITY, BUT THAT PCI WOULD NEVER HAVE STRENGTH TO CONTROL GOVERNMENT. ANOTHER BANKER THOUGHT PCI HAD REACHED PEAK OF ITS POWER AND THAT ITS INFLUENCE WOULD DIMISH. BUT SHOULD THEY COME TO POWER, HE ADDED, WE COULD GET ALONG WITH THEM. "WE HAVE BEEN IN ITALY A LONG TIME." HEAD OF LARGE CHEMICAL
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AND PHARMACEUTICAL MULTINATIONAL SAID HIS COMPANY HAD ESTABLISHED PLANTS IN YUGOSLAVIA AND WAS READY TO SHOW COMMUNISTS IT COULD WORK WITH THEM. IN ANY CASE, SAID DIRECTOR OF ANOTHER AMERICAN-OWNED MULTINATIONAL, WASHINGTON'S POLICY TOWARD ANY FUTURE COMMUNIST GOVERNMENT WOULD DETERMINE OUR CHANCES OF SURVIVAL. WE COULD NOT LAST FIVE YEARS IN TENSION-FILLED ENVIRONMENT, WHEREAS WE COULD CONTINUE INDEFINITELY IN ONE WHERE DIALOGUE AND RELAXED RELATIONS WITH WASHINGTON EXISTED.

12. WHAT THE GOVERNMENT DOES WITH ECONOMY, MOST AGREE, WILL DETERMINE PACE OF RECOVERY. FEELING IS WIDESPREAD THAT BASIC ECONOMIC PROBLEMS--LARGE GOVERNMENT DEFICIT, HIGH INFLATION, LACK OF CONFIDENCE--STILL EXIST DESPITE RECENT UPTURNS. PRESENT GOVERNMENT IS CONSIDERED BY MANY TO BE TOO WEAK TO CARRY OUT FIRM POLICY NEEDED AND UNTIL BUSINESSMEN SEE GOVERNMENT ACTUALLY TAKING MEASURES TO COPE WITH THESE PROBLEMS, CONFIDENCE WILL PROBABLY REMAIN AT LOW EBB.

13. DESPITE VARYING DEGREES OF OPTIMISM, THERE IS LITTLE

DOUBT IN MINDS OF ALMOST EVERYONE THAT ECONOMY HAS TURNED UP.
ASSOLOMBARDA OFFICIAL CLAIMED THAT RECOVERY IS UNDERWAY,
THAT IT IS BIGGER THAN IT LOOKS, BUT THERE IS STILL TOO MUCH
UNCERTAINTY. IN ANY EVENT, WRESENT OPTIMISM IS AN UNMISTAKEABLE
REVERSAL OF ATTITUDE DURING PAST TWO YEARS WHEN ALMOST UNIVERSAL
JUDGEMENT WAS OF STEADY DECLINE - WHATEVER THE REALITY MAY
HAVE BEEN THEN OR NOW.FINA

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